FitchRatings

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# Fitch Affirms Maricopa County's (AZ) GOs & Lease Revs; Outlook Stable

Ratings Endorsement Policy
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Fitch Ratings-Austin-27 March 2013: Fitch Ratings affirms the rating on Maricopa County, Arizona's outstanding debt as follows:

--$130.8 million outstanding Public Finance Corporation lease revenue bonds at 'AA+';
--Unlimited tax general obligation (ULTGO) bond rating (implied) affirmed at 'AAA'.

The Rating Outlook is Stable.

SECURITY:
The lease revenue bonds are secured by lease payments from the county to the corporation, subject to annual appropriation by the county. The bonds are further secured by a cash-funded debt service reserve fund.

KEY RATING DRIVERS

DIMINISHED BUT STILL SOLID FINANCIAL POSITION: General fund reserves and liquidity are diminished from pre-recessionary highs due to sizeable annual pay-go capital spending, but remain sound. Available balances outside the general fund further bolster reserves. Management's historically conservative and proactive fiscal practices have enabled continued structural balance while weathering various economic and financial pressures largely associated with the collapse of the area housing market. However, Fitch believes the county's ability to further reduce spending as a budgetary tool is minimal.

STANDARD SECURITY PROVISIONS: Although lease payments are subject to annual appropriation, Fitch believes incentive to appropriate is enhanced by the essentiality of the leased assets that would be forfeited in the event of non-appropriation. The cash-funded debt service reserve fund provides some protection against a temporary disruption in payment.

SIGNS OF MODESTLY IMPROVING ECONOMY: Economic conditions remain weak, although some resilience is evident with employment, housing market, and sales tax trends reflecting modest year-over-year improvement. Fitch anticipates a continued, slow pace of economic recovery over the near term but believes long-term prospects are positive, given the area's history of attracting businesses and residents.

MULTI-YEAR TAX BASE DECLINES: The county's tax base has realized a sizeable, cumulative 35% decline in primary assessed valuation (PAV) over the last three fiscal years (2011-2013); the drop reversed previously rapid tax-base expansion. Taxpayer concentration is minimal.

MODERATE LONG-TERM LIABILITIES: The overall debt burden is above average given recent, sizeable tax base declines. This is balanced against the county's very modest direct debt position, reflecting management's aversion to debt and practice of financing sizeable capital needs largely on a pay-go basis. Carrying costs are low and other long-term, legal liabilities have largely been settled.

RATING SENSITIVITIES

DETERIORATION OF FINANCIAL CUSHION: Material deterioration of solid reserve levels that provide substantial financial flexibility or evidence of structural budget imbalance could signal a fundamental shift in the county's credit profile, leading to negative rating action.

CREDIT PROFILE
Maricopa County is the economic and population center of Arizona, encompassing Phoenix and surrounding suburbs within its large, roughly 9,000 square mile boundary. Phoenix was the nation's fastest growing major U.S. city from 1990-2000, with a 34% population increase. County population expanded accordingly and totals about 4 million residents currently, establishing it as the fourth most populated county in the U.S. Local income/wealth levels exceed the state by about 10% and are generally comparable to the nation. Educational attainment is also in line with the U.S.

SLOW ECONOMIC RECOVERY EXPECTED
Rapid population growth fed the housing construction boom, which ultimately resulted in the collapse of the housing market beginning in 2008. The housing market's deterioration was one of the most severe in the nation and in conjunction with the recession, weakened the local economy despite its large and fairly diverse nature. The area has begun to show signs of modest economic improvement. Trade/transportation/utilities, professional/business services, and education/health services represent the largest employment sectors in the metropolitan statistical area (MSA). Solid year-over-year employment gains balanced against modest labor force growth have led to lowered unemployment levels of 6.4% in November 2012 (down from an elevated 7.6% a year ago) that fall below those of the state (7.5%) and the U.S. (7.4%). In addition, housing data reflect recent modest gains in home values. However, only modest new development is expected over the near term given the inventory of vacant commercial and residential property that remains and, therefore, Fitch assumes the construction sector will not regain its previous position as a key employment sector soon.

STEEP AV DECLINES LARGELY OFFSET PREVIOUS RAPID GAINS
The county has historically realized sizeable year-over-year tax base gains given the nature of the housing market and the area's expansion pre-recession. However, the economic downturn that resulted in minimal new construction and steep declines in home values led to equally as steep tax base declines in recent years. PAVs, which lag market values by two years and from which the county's operating revenue is determined have fallen a cumulative 35% over fiscals 2011-2013. The trough of the decline reached 18% in fiscal 2012. Taxpayer concentration remains modest at 6%, although there is some energy sector concentration with many of the top 10 taxpayers consisting of large power generation facilities. Nonetheless, preliminary expectations by the Maricopa County Assessor's Office for fiscal 2014 favorably anticipate a change to this recent flat to declining PAV trend with a modest 3.5% gain (excluding any impact from new construction). If realized, this modestly positive gain would be roughly a year ahead of management's conservative, multi-year forecasts.

Of note is Proposition 117, which was approved by Arizona voters in November 2012 as a constitutional amendment. This legislation will limit annual increases in existing property values to 5%, beginning in fiscal 2016 (2014 real property valuations). Fitch will continue to monitor the evolving impact over the near term as it reflects a significant change to the property assessment process.

FINANCIAL POSITION REMAINS SOUND DESPITE REDUCED RESERVES
The county's financial profile is sound despite recent economic pressures and their impact on various revenue sources. Fitch views management's strong and historically conservative fiscal practices that include conservative revenue estimates and multi-year financial/economic forecasting as a key component of these results.

Operating reserves have been reduced by nearly one-half since 2008, but balances remain substantial; the unrestricted general fund balance totaled $283 million or 23% of spending at June 30, 2012 despite the year's $126 million drawdown. The drawdown was primarily used to fund non-recurring capital spending. Reserve levels have historically fluctuated somewhat from year to year as the county maintains its practice of funding sizeable capital needs from available resources.

County operations are funded by a fairly diverse revenue stream, led by local property taxes that provide about 55% of general operating revenues followed by state-shared sales tax and vehicle license tax revenues. The county also benefits from a county-wide sales tax levy approved by voters to fund jail operations. Declines in property tax revenue have been offset in part with slow, sluggish gains in sales taxes from a modestly improving economy. General operating revenues totaled $1.1 billion in fiscal 2012 and have trended flat on a year-over-year basis since 2010.

Annual expenditures comprise a high level of constitutionally mandated services as well as shifts in funding responsibility to the county since 2008 given the state's own budget woes. Management has leaned heavily on available spending reductions in order to maintain its financial position. This has also served to largely offset the Board's decision not to utilize the full value of an increased operating tax levy allowable by law against a much reduced PAV over fiscals 2011-2013. The county is limited to a 2% levy increase year-to-year (excluding gains from new property). General operations have been reduced by a sizeable $169 million, roughly 14% from budgeted fiscal 2007 spending levels.

The $1 billion fiscal 2013 operating budget was adopted as structurally balanced and assumes modest increases in certain economically sensitive revenues, although overall, it is down roughly 2% or $33 million from the prior year's revised budget. The decision to maintain a flat tax rate in fiscal 2013 rather than offsetting the year's 11% PAV decline resulted in a $53 million property tax revenue decline. As is the county's standard budgeting practice, non-recurring spending was addressed with the budgeted use of fund balance, which must be included for the next year's spending according to state statute.

Year-to-date, management reports revenue trends are running slightly ahead of budget by 2% while expenditures are down by about 3%. Current projections are for a year-end general fund balance at no less than approximately $230 million or about 22% of total operational spending as the county applies a portion of the fund balance to various capital projects and other non-recurring spending needs. Also, the county has some additional financial cushion with about $95 million set aside for future pay-go capital projects that could support other Board spending priorities as needed.

Looking ahead, Fitch believes the county's ability to further reduce spending as a budgetary tool is minimal. Management's preliminary five-year financial forecasts beginning in fiscal 2014 anticipate growing structural budgetary imbalance under a flat tax rate scenario and only modest PAV gains beginning in fiscal 2015. Nonetheless, Fitch believes these are conservative projections and takes comfort from management's fiscal practices that have maintained healthy reserves and sufficient financial flexibility well above the low 5% reserve level according to policy. This is evident in the Board's decision to commit a sizeable portion of general fund reserves in the last two fiscal years (totaling $159 million or about 13% of spending in fiscal 2012) particularly for budget stabilization purposes, which served to provide the bulk of management's informal fund balance target of no less than $200 million.

MODERATE LONG-TERM LIABILITIES
The overall debt burden has risen to an above-average level and approximates $4,700 per capita and 5.7% of market value due largely to the recent trend of assessed valuation declines. This is in contrast to the county's very modest debt position. Long-term capital planning is an integral part of county operations. The county's five-year capital plan totals $955 million with public safety as the largest component. Management has no debt or bond election plans; minimal change is anticipated over the near term to the county's historical pay-go philosophy despite recent new Board members.

The county has no GO debt outstanding. Amortization of the county's outstanding lease revenue bonds is slightly above average at 58%. The lease structure that governs the outstanding lease revenue bonds has characteristics that Fitch considers standard, including essential leased assets and that the trustee can repossess in the event of non-appropriation or default.

Other long-term liabilities have largely been settled, including a lawsuit for payment of the county's previous responsibility for indigent health care that was settled for $45 million in fiscal 2013 and recorded as a liability in fiscal 2012. Also, the large $80 million deficit net asset position at fiscal 2012 year-end in the county's internal risk management fund based on actuarial assumptions is expected to be significantly reduced in the near term. County management reports most of the lawsuits associated with the alleged abuse of power among various county officials have recently been resolved for lower than assumed amounts.

The county participates in four retirement plans, the largest of which is the Arizona State Retirement System (ASRS) which includes disability, death and healthcare benefits and is a cost-sharing, multiple employer plan (CSME). Contributions for all four plans are statutory, but also based on actuarial assumptions. The county has contributed 100% of the annual pension/OPEB cost over the past three years for all four plans. The overall ASRS funded position at year-end fiscal 2012 totaled almost 76%, which was a below-average 68% using the Fitch-adjusted 7% discount rate. Also, the June 30, 2012 funded position for the other three agent, multiple employer (AME) plans was weak after adjusting for a more conservative 7% discount rate and range from a very low 38.5% to nearly 62%, which Fitch still considers weak. Carrying costs are very low, totaling 5.1% of total governmental funds in fiscal 2012, and are expected to remain manageable even with probable increases to annual pension/OPEB costs over the near term.

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In addition to the sources of information identified in the Tax-Supported Rating Criteria, this action was additionally informed by information from Creditscope, Case-Shiller Index, and IHS Global Insight.

Applicable Criteria and Related Research:
'Tax-Supported Rating Criteria', Aug. 14, 2012
'U.S. Local Government Tax-Supported Rating Criteria', Aug. 14, 2012

**Applicable Criteria and Related Research**
Tax-Supported Rating Criteria
U.S. Local Government Tax-Supported Rating Criteria